Supreme Court, U.S.
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No. _____

IN THE
Supreme Court of the United States

DEVON ENERGY CORPORATION,

Petitioner,

v.

KENNETH L. SALAZAR,
SECRETARY OF THE INTERIOR,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

APPENDICES TO PETITION FOR A WRIT OF CERTIORARI

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APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued September 15, 2008 Decided December 23, 2008

No. 07-5299

DEVON ENERGY CORPORATION,
APPELLANT

v.

DIRK KEMPTHORNE, SECRETARY OF THE INTERIOR,
APPELLEE

Appeal from the United States District Court
for the District of Columbia
(No. 04cv00821)

Deborah B. Haglund argued the cause for appellant. With her on the briefs was *Charles D. Tetrault*.

Erik Milito and *Michele Schoeppe* were on the brief for *amicus curiae* American Petroleum Institute in support of appellant.

Sambhav N. Sankar, Attorney, U.S. Department of Justice, argued the cause for appellee. With him on the brief was *Michael T. Gray*, Attorney. *R. Craig Lawrence*, Assistant U.S. Attorney, entered an appearance.

Before: BROWN, *Circuit Judge*, and EDWARDS and SILBERMAN, *Senior Circuit Judges*.

Opinion for the Court filed by *Senior Circuit Judge* EDWARDS.

EDWARDS, *Senior Circuit Judge*: The United States leases the rights to extract and sell natural

gas from lands owned by the Government. In exchange, lessees, like appellant Devon Energy Corporation ("Devon"), agree to pay the United States royalties on the natural gas they are able to produce. This case arises from a final order issued by the United States Department of the Interior ("DOI" or "Interior") requiring Devon retroactively to recalculate royalties owed to the Government pursuant to its lease to extract coalbed methane from federal land in Wyoming.

At issue is the agency's interpretation of its "marketable condition rule." The rule was included as a part of DOI's 1988 Revision of Gas Royalty Valuation Regulations, which establish the framework for calculating the royalty value of coalbed methane gas production. In its disputed order, DOI held that the marketable condition rule precluded Devon from deducting certain costs associated with compression and dehydration when calculating the "gross proceeds" upon which royalties are owed. DOI determined that gas cannot enter a pipeline and move to a purchaser unless it meets the requirements of the pipeline, which typically requires compression to raise its pressure and dehydration to reduce its water content. Thus, DOI concluded that if gas is not sufficiently compressed and dehydrated to be deliverable to the point of purchase through the pipeline, it is not in marketable condition. Devon filed suit in the District Court to challenge Interior's order. The District Court denied Devon's motion for summary judgment and granted the Secretary's cross-motion. On appeal, Devon argues that DOI's order is inconsistent with the plain language of the

marketable condition rule, and also inconsistent with DOI's own prior interpretation of the rule.

We affirm the judgment of the District Court. First, we find that Interior's interpretation of the marketable condition rule reflects a perfectly reasonable construction of the rule. It is clear that the agency's order is not at odds with the plain language of the rule, nor does it effectively "amend," rather than reasonably construe, the rule. Second, we reject Devon's claim that DOI's order conflicts with a prior interpretation of the marketable condition rule. Devon argues that its position finds support in guidance documents distributed by agency personnel after DOI's promulgation of the 1988 regulations. However, as Devon concedes, these contested guidance documents were distributed by agency individuals who had no authority either to amend the marketable condition rule or to issue authoritative guidelines on behalf of the agency.

I. BACKGROUND

A. *Statutory and Regulatory Framework*

Through its Minerals Management Service ("MMS"), Interior issues and administers leases authorizing the removal of natural gas from federal land. The Mineral Leasing Act, 30 U.S.C. §§ 181 *et seq.* (2000), "was intended to promote wise development of these natural resources and to obtain for the public a reasonable financial return on assets that 'belong' to the public." *California Co. v. Udall*, 296 F.2d 384, 388 (D.C. Cir. 1961). Under the Mineral Leasing Act, the producer-lessees must pay the government-lessor "a royalty at a rate of not less than 12.5 percent in amount or value of the

production removed or sold from the lease." 30 U.S.C. § 226(b)(1)(A). In the Federal Oil and Gas Royalty Management Act, the Secretary of the Interior was instructed by Congress to create a comprehensive inspection, collection, accounting, and auditing system to ensure that the government receives the royalties owed. 30 U.S.C. § 1711(a) (1982).

The Mineral Leasing Act gives DOI the authority "to prescribe necessary and proper rules and regulations and to do any and all things necessary to carry out and accomplish the purposes of" the Act. 30 U.S.C. § 189. Pursuant to this directive, DOI has issued a number of regulations governing the royalty valuation process. In 1988, DOI conducted a major rulemaking that modified the then-existing gas royalty valuation regulations. *See* Revision of Gas Royalty Valuation Regulations and Related Topics, 53 Fed. Reg. 1230, 1272 (Jan. 15, 1988); 30 C.F.R. § 206.152 (1988). The 1988 regulations establish the framework for calculating the royalty value of the coalbed methane gas production at issue here. Under this regulatory framework, royalties are calculated on the basis of the total value a lessee receives for its production. The regulations specify that the "value of production" should be no less "than the gross proceeds accruing to the lessee for lease production," minus certain allowable deductions. 30 C.F.R. § 206.152(h); *see also Amoco Prod. Co. v. Watson*, 410 F.3d 722, 725 (D.C. Cir. 2005), *aff'd sub nom., BP Am. Prod. Co. v. Burton*, 549 U.S. 84 (2006).

When calculating "gross proceeds," DOI regulations have long interpreted the Mineral Leasing Act to require lessees to put the gas into marketable condition at no cost to the United States

– the so-called "marketable condition rule." The 1988 regulations confirmed this requirement. *See* 30 C.F.R. § 206.152(i) (governing unprocessed gas); 30 C.F.R. § 206.153(i) (governing processed gas); *see also California Co.*, 296 F.2d at 387-88 (affirming marketable condition requirement). Marketable condition is defined in the DOI regulations as "lease products which are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area." 30 C.F.R. § 206.151. If a lessee sells "unmarketable" gas at a lower price, the gross proceeds are "increased to the extent that the gross proceeds have been reduced because the purchaser, or any other person, is providing certain services" to place the gas in marketable condition. 30 C.F.R. § 206.152(i); *Amoco*, 410 F.3d at 725-26.

The 1988 regulations also provide that the lessee may deduct its actual costs of transporting the gas from the wellhead to the point of sale when gas produced from the lease is sold at a market remote from the lease. 30 C.F.R. § 206.157(a)-(b). This "transportation allowance" includes "only those costs which are directly related to the transportation of lease production." 53 Fed. Reg. at 1261. A transportation allowance is defined as "an allowance for the reasonable, actual costs of moving [gas] to a point of sale or delivery off the lease . . . or away from a processing plant." 30 C.F.R. § 206.151.

B. *Facts and Proceedings Below*

Devon leases land from the United States in Wyoming's Powder River Basin, which contains the natural gas known as coalbed methane. These leases cover three fields – Kitty, Spotted Horse, and Rough

Draw – each of which contains a large number of individual gas-producing wells. The gas produced from the wells is gathered at central delivery points ("CDPs") that have been approved by the Bureau of Land Management as the points of measure for the royalty due on the gas. After the gas leaves a CDP, it goes through a complex series of compression and dehydration processes as it travels "downstream" to the Buckshot processing plant in preparation for eventual sale. *See* Valuation Determination for Coalbed Methane Production from the Kitty, Spotted Horse, and Rough Draw Fields, *reprinted in* Joint Appendix ("J.A.") 57 ("Valuation Determination"); *see also* Chart, J.A. 460.

The production process varies slightly in the three fields, but the differences are not material. Essentially, each CDP is connected to a small diameter pipeline. Gas travels from the CDP through the pipeline to one of several "screw compressors," which compress the gas to raise its pressure. The gas then travels through the pipeline to a "field booster," a reciprocating compressor that further raises the pressure of the gas. The gas then enters a dehydrator, which removes water. Valuation Determination, J.A. 61. At this point, the gas enters a 24-inch high-pressure gas pipeline, which begins at what is known as the Landeck Station and runs 126 miles to the Buckshot Gas Plant. Approximately 30 miles from the Landeck Station, the gas enters a large compressor called the "MTG Booster," which compresses the gas to raise the pressure from 450-500 pounds per square inch ("psi") to approximately 1,200 psi. The gas travels the remaining 96 miles to the Buckshot Gas Plant,

losing approximately one-third of its pressure on the way. *Id.* at 66.

When the gas arrives at the Buckshot Gas Plant, excess carbon dioxide is removed, the gas is dehydrated, and the gas is compressed from approximately 800 psi to 1,100 psi. At that pressure, Devon delivers the treated gas into one of two lateral pipelines. The gas is transported to various purchasers through these pipelines. *Id.*

On November 2, 1995, DOI and MMS personnel serving on a group called the Royalty Policy Board met to discuss how the royalty calculation regulations should be applied to coalbed methane production. *See* Royalty Policy Board Meeting Minutes, Nov. 2, 1995, *reprinted in* J.A. 102. Subsequently, on December 7, 1995, and December 8, 1995, the then-Deputy Director of MMS issued two documents captioned "Coalbed Methane Valuation and Reporting Guidelines" and "Compression Guidance," respectively. *See* Coalbed Methane Valuation and Reporting Guidelines, Dec. 7, 1995, *reprinted in* J.A. 157; Compression Guidance, Dec. 8, 1995, *reprinted in* J.A. 160 [hereinafter, along with the "Dear Operator" letter, *infra*, "guidance documents"]. These documents were memoranda from the Deputy Director to the Associate Director for Royalty Management and the Associate Director for Policy and Management Improvement. J.A. 83. Although they were not promulgated pursuant to the notice-and-comment procedures of the Administrative Procedure Act ("APA"), 5 U.S.C. § 553 (2000), the guidance documents nonetheless suggested that certain costs of compression and

dehydration after the gas leaves the CDP were deductible as transportation costs.

Subsequently, on April 22, 1996, MMS's Associate Director for Royalty Management distributed a "Dear Operator" letter detailing how to calculate royalties on coalbed methane production. The letter stated:

> If you sell your coalbed methane at the tailgate of a carbon dioxide removal or other treating facility . . . [y]ou can include costs of dehydration occurring after metering at the royalty measurement point in your transportation allowance but you cannot deduct costs of dehydration occurring at the wellhead. You can include costs for compression occurring downstream of the royalty measurement point, to the extent the compression is necessary for transportation. This includes compression at the CDP and in the transportation system to the [carbon dioxide] removal facility.

MMS Dear Operator Letter, Apr. 22, 1996, *reprinted in* J.A. 162, 164 [hereinafter, along with the "Coalbed Methane Valuation and Reporting Guidelines" and the "Compression Guidance," *supra*, "guidance documents"].

From 1995 to 2002, Devon deducted the following costs as transportation allowances: the cost of compressing the gas at the screw compressors, the field boosters, the MTG Booster, and the Buckshot Gas Plant, as well as the cost of dehydrating the gas. Devon apparently assumed that these expenses were deductible transportation costs under the guidance documents. On January 11, 2002, however, Devon sought guidance from MMS to confirm that it was

properly deducting (as part of its transportation allowance) dehydration and compression costs incurred after the gas leaves the CDPs. Request for Valuation Determination, Jan. 11, 2003, *reprinted in* J.A. 166. On October 9, 2003, the Acting Assistant Secretary issued a decision rejecting Devon's reliance on the guidance documents. *See* Valuation Determination, J.A. 57.

In its Valuation Determination, the agency found that statements in the guidance documents were either ambiguous, J.A. 84-85, or reflected an incorrect application of the marketable condition rule, J.A. 84, or were simply "inconsistent" with the rule, J.A. 85. The DOI Valuation Determination held that Devon's deductions of the costs of dehydration and of compression performed at the screw compressors, the reciprocating compressors, and the Buckshot Plant were inconsistent with the marketable condition rule, because the compression and dehydration functions were necessary to put the production into marketable condition.

> Devon could not meet the requirements of any of its sales contracts without compressing the gas to the pressure necessary to get it into those [pipe]lines . . . . That is the pressure that would enable the gas to be "accepted by a purchaser under a sales contract typical for the field or area," in the words of the definition [of the marketable condition rule] at 30 C.F.R. § 206.151. In other words, to meet the requirements of the "sales contract[s] typical for the field or area," Devon had to compress the gas to pipeline pressure.

Id. at 88.

> Both before and after the 1988 regulations, the lessee's obligation is to dehydrate gas to the water content required for delivery to the pipeline (as necessary for sale under contracts that are typical for the disposition of gas produced from the field or area). . . .
>
> Devon has not shown that the dehydration performed after the reciprocating compressors and at the Buckshot Plant is for anything other than what is required to put the production into marketable condition and what is necessary for it to meet pipeline and purchaser requirements.

Id. at 91.

Devon's request for reconsideration of the DOI Valuation Determination was denied in March 2004. Final Order to Perform Restructured Accounting and Pay Additional Royalties ("Final Order"), Mar. 19, 2004, *reprinted in* J.A. 46. The DOI Final Order largely reaffirmed the reasoning and conclusions reached in the DOI Valuation Determination. Devon was instructed to "perform a restructured accounting and pay additional royalties on the coalbed methane produced from the Federal leases" that were the subject of the DOI Valuation Determination. J.A. 55. Devon was also instructed that, in the future, it was to "report and pay royalties under the regulations and guidelines discussed" in the DOI Final Order. *Id.*

Devon filed suit in the District Court seeking to overturn the Final Order. The District Court denied Devon's motion for summary judgment and granted Interior's cross-motion for summary judgment. *Devon Energy Corp. v. Norton*, No 04-Civ-0821, 2007

WL 2422005 (D.D.C. Aug. 23, 2007). This appeal followed.

II. Analysis

A. *Standard of Review*

"In a case like the instant one, in which the District Court reviewed an agency action under the APA [5 U.S.C. § 706], we review the administrative action directly, according no particular deference to the judgment of the District Court." *Holland v. Nat'l Mining Ass'n*, 309 F.3d 808, 814 (D.C. Cir. 2002); *see also Troy Corp. v. Browner*, 120 F.3d 277, 281 (D.C. Cir. 1997); *Gas Appliance Mfrs. Ass'n, Inc. v. Dep't of Energy*, 998 F.2d 1041, 1045 (D.C. Cir. 1993). We will uphold the contested agency action unless we find it to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A).

An agency's interpretation of its own regulation is entitled to "substantial deference," unless "plainly erroneous or inconsistent with the regulation." *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994) (internal quotation marks omitted). However, an agency may not "evade [the] notice and comment requirements [of § 553 of the APA, 5 U.S.C. § 553(b)(A),] by amending a rule under the guise of reinterpreting it." *Envtl. Integrity Project v. EPA*, 425 F.3d 992, 995 (D.C. Cir. 2006) (quoting *Molycorp, Inc. v. EPA*, 197 F.3d 543, 546 (D.C. Cir. 1999)); *see also Am. Hosp. Ass'n v. Bowen*, 834 F.2d 1037, 1044-48, 1052-57 (D.C. Cir. 1987). In determining whether an agency action effectively "amends" a rule without adhering to the requirements of the APA, we must consider, *inter alia*, whether the agency

officials involved in the disputed actions had the authority to issue binding regulations or otherwise act with the force of law on behalf of the agency. *See generally* HARRY T. EDWARDS & LINDA A. ELLIOTT, FEDERAL STANDARDS OF REVIEW – REVIEW OF DISTRICT COURT DECISIONS AND AGENCY ACTIONS 130-35 (2007).

B. *Plain Language*

Under the 1988 DOI regulations, "marketable condition" is defined to mean "lease products which are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area." 30 C.F.R. § 206.151. The marketable condition rule requires lessees to put gas into marketable condition at no cost to the United States. At issue here is DOI's interpretation of the rule to include the costs of compression and dehydration incurred after the gas leaves the CDPs to allow it to move through the pipelines that serve the market in which the gas is typically sold. Devon argues that this interpretation is inconsistent with the plain language of the regulations, because it improperly focuses the inquiry on the market where the gas is actually sold, as opposed to the requirements of a sales contract typical for the field or area.

In its Valuation Determination and Final Order, DOI held that costs associated with compression and dehydration are not deductible if their primary function is to prepare the gas to move through the pipelines to the point where gas is purchased. However, the parties disagree as to what "sales contract typical for the field or area" requires. DOI found that "typical" sales contracts require that gas be delivered to the purchaser at the terminus of a

specified pipeline. Under this view, a producer must provide the compression and dehydration necessary to allow the gas to be delivered through the pipeline. Therefore, the agency reasonably found that Devon "could not meet the requirements of any of its sales contracts without compressing the gas to the pressure necessary to get it into" the pipelines, J.A. 88, and that Devon had "not shown that the dehydration performed . . . [was] for anything other than what is required to put the production into marketable condition . . . to meet pipeline and purchaser requirements." J.A. 91.

It is true that the DOI marketable condition rule is ambiguous, and Devon's preferred interpretation of the rule is not unreasonable. In other words, we assume that the costs of dehydration and compression can reasonably be interpreted to fall within the compass of "transportation costs." However, we are obliged to afford "substantial deference to an agency's interpretation of its own regulations." *Thomas Jefferson Univ.*, 512 U.S. at 512 (citations omitted). On this record, we find that DOI's contested construction of the marketable condition rule is reasonable. Indeed, DOI's interpretation of the marketable condition rule is consistent with an interpretation that this court approved in *Amoco*, 410 F.3d 722.

In *Amoco*, we addressed DOI's interpretation of the marketable condition rule as it related to the cost of transporting excess carbon dioxide to the treatment plant. The court held that the marketable condition rule did not require DOI to "understand typical sales contracts – and thus marketable condition – as relating to transactions at the

leasehold or immediately nearby." *Id.* at 729. "The regulation stipulating that producers are to place gas in marketable condition at no cost to the government does not contain a geographic limit." *Id.* Therefore, DOI's interpretation of the marketable condition rule to require lessees to compress and dehydrate gas to meet the requirements of the pipelines that serve its typical purchasers is not "plainly erroneous or inconsistent with the regulation." *Thomas Jefferson Univ.*, 512 U.S. at 512. And as the court noted in *Amoco*, the deference that we owe to an agency's interpretation of its own regulations "is particularly appropriate in the context of a complex and highly technical regulatory program, in which the identification and classification of relevant criteria necessarily require significant expertise and entail the exercise of judgment grounded in policy concerns." 410 F.3d at 729 (citations and quotations omitted).

C. ***The Requirements of a Typical Sales Contract***

Devon argues that there is no record support for the agency's conclusion that the typical sales contract for the field or area required Devon to compress its gas to 1,100 psi and dehydrate it in order to put the gas in marketable condition. However, although DOI provided Devon an opportunity to supplement the record after the first valuation determination, Devon merely asserted that it "believes that its working interest partner, Redstone Resources, Inc., sells gas to unrelated third parties in the field at pressures less than 1200 psi [sic] under contracts typical for the field or area." Request for Reconsideration and/or Clarification, *reprinted in* J.A. 194, 196. This cursory assertion is

not sufficient to render DOI's interpretation unreasonable.

D. *Prior Inconsistent Interpretation*

Finally, Devon argues that the agency's interpretation of the marketable condition rule (embodied in the DOI Valuation Determination and Final Order) must be vacated because it was issued without notice-and-comment rulemaking required by § 553 of the APA. At bottom, Devon's central claim is that it acted in reliance on the guidance documents and this "reliance interest is protected by the APA." Appellant's Br. at 16. Devon's argument runs as follows:

> The marketable condition rule does not prohibit the deduction of transportation costs, and it does not attempt to differentiate between deductible transportation costs and nondeductible marketable condition costs. Because the regulations do not expressly address the issue, the Royalty Policy Board was called upon to interpret the regulations. [*Id.*]
>
> [The Board's] decision gave rise to [the guidance documents] which were consistently followed by Interior from 1995 until 2003. [*Id.*]
>
> Devon followed Interior's publicly-announced guidelines and instructions when it deducted its post-CDP dehydration and compression costs. [*Id.*]
>
> Interior's decision in this case wrongly assumes that Interior was not bound by its 1995 guidelines and instructions because they were not embodied in a formal regulation. This Court has long recognized that an agency interpretation can be

> authoritatively adopted even if it was not embodied in a rule that was adopted through a notice and comment rulemaking. [*Id.* at 17.]
>
> An agency's consistent advice – and here it was instruction – to the regulated community can evidence the agency's authoritative adoption of a regulatory interpretation. Such an interpretation can be changed only through a notice and comment rulemaking. [*Id.*]

DOI's description of the situation is quite different. According to the agency, there was no official or binding Royalty Policy Board action taken to address the issues now before the court. Rather, DOI contends that

> [n]otice and comment rulemaking was . . . not required for Interior to change its interpretation of its regulation from how it had been applied as a result of ambiguous guidance documents. This Court has held that the very same guidance documents were not binding on the agency. [*See Amoco*, 410 F.3d at 732.] If they were not binding, then they are not evidence of a definitive agency interpretation and Interior can change its interpretation without going through notice and comment rulemaking. . . . Absent a definitive interpretation, the APA does not require notice and comment rulemaking to effect a change in that interpretation.

Appellee's Br. at 15-16. For the reasons stated below, we agree with DOI.

First, it is telling that the agency's disputed Valuation Determination and Final Order came only after Devon sought confirmation from the agency

that it was properly deducting the dehydration and compression costs (as part of its transportation allowance) incurred after the gas leaves the CDPs. This request for confirmation was made in 2002, long after the issuance of the guidance documents upon which Devon now relies. It is perplexing, to say the least, that Devon was seemingly confused over the propriety of its royalty accounting if, in its view, the matters at issue had been authoritatively resolved over five years earlier. In other words, there is much force to DOI's argument that, in fact, the guidance documents were far from conclusive in what they said.

Second, implicit in Devon's prior-inconsistent-interpretation argument is a claim that the judgments reached in DOI's Valuation Determination and Final Order do not reflect a supportable interpretation of the marketable condition rule. As we have already explained in part II.B, *supra*, we find no merit in this claim. Although the marketable condition rule is ambiguous and Devon's preferred construction of the rule is not unreasonable, we are obliged to defer to the agency's reasonable construction of the rule. *Thomas Jefferson Univ.*, 512 U.S. at 512 (holding that an agency's interpretation of its own regulation is entitled to "substantial deference," unless "plainly erroneous or inconsistent with the regulation").

Third, and most important, Devon is mistaken in its argument that the guidance documents constituted authoritative and binding interpretations of the marketable condition rule. In rejecting Devon's argument, we start with the principle that agency actions do not have the force of law unless

they "mark the consummation of the agency's decisionmaking process" and either determine "rights or obligations" or result in discernible "legal consequences" for regulated parties. *Bennett v. Spear*, 520 U.S. 154, 177-78 (1997). The "Dear Operator" letter certainly does not satisfy this standard. Indeed, this court has previously considered a different aspect of the very same "Dear Operator" letter that is at issue in this case. *See Amoco*, 410 F.3d at 732.

In *Amoco*, coalbed methane producers challenged an Assistant Secretary's decision that cited the April 22, 1996 letter, arguing that it constituted a new rule that the agency could promulgate only through notice-and-comment rulemaking. Citing *Independent Petroleum Ass'n of America v. Babbitt*, 92 F.3d 1248, 1256-57 (D.C. Cir. 1996), the court rejected Amoco's argument because the letter was not binding on the agency:

> As in *Babbitt*, the Payor Letter here is not an agency statement with future effect because nothing under DOI regulations vests the Letter's author – in *Babbitt* and this case MMS's Associate Director for Royalty Management – with the authority to announce rules binding on DOI. *Id.* at 1256. "The letter is not an agency rule at all, legislative or otherwise, because it does not purport to, nor is it capable of, binding the agency." *Id.* at 1257.
>
> . . . .
>
> The sort of "workaday advice letter[s] that agencies prepare countless times per year in dealing with the regulated community," *Indep. Equip. Dealers Ass'n v. EPA*, 372 F.3d 420, 427

> (D.C. Cir. 2004) (internal quotation marks omitted), do not retroactively become agency rules whenever they are referenced in an agency decision.

Amoco, 410 F.3d at 732.

In response to the *Amoco* holding, Devon says that it "does not contend that the 1996 Dear Operator letter in and of itself was a binding rule. Rather, Devon contends that the regulatory interpretation it relied on was authoritatively adopted by the agency through the cumulative effect of a number of agency actions, including but not limited to, the issuance of the 1996 Dear Operator letter." Devon Reply Br. at 14. There are two problems with this argument. First, it assumes that the two internal memoranda written by the Deputy Director of the Minerals Management Service in 1995 to the Associate Director for Royalty Management and the Associate Director for Policy and Management Improvement were final and binding agency interpretations of the marketable condition rule. Second, it assumes that the guidance documents have the force of law because Devon followed the advice contained in the documents. There is no merit to these contentions.

Devon argues that these 1995 documents were conclusive because they reflected the actions of the Royalty Policy Board, as if to suggest that the Board had authority to adopt regulations or guidelines that bind the agency. But when questioned about this at oral argument, Devon's counsel readily conceded that the Royalty Policy Board had no authority to issue authoritative guidelines, and that the guideline documents did not have the force of law. This

concession is unsurprising, because there is *nothing* in the record here to indicate that the guidance documents purported to have the force of law.

At the very least, a definitive and binding statement on behalf of the agency must come from a source with the authority to bind the agency. *See Ctr. for Auto Safety v. Nat'l Highway Traffic Safety Admin.*, 452 F.3d 798, 810 (D.C. Cir. 2006) (holding that Associate Administrator for Safety Assurance had no authority to issue guidelines with binding effect on agency); *Ass'n of Am. R.Rs. v. DOT*, 198 F.3d 944, 948 (D.C. Cir. 1999) (holding a letter and two emails from lower level officials did not amount to an authoritative agency interpretation); *Paralyzed Veterans of Am. v. D.C. Arena L.P.*, 117 F.3d 579, 587 (D.C. Cir. 1997) (stating that a speech of a mid-level official of an agency "is not the sort of 'fair and considered judgment' that can be thought of as an authoritative departmental position") (citing *Auer v. Robbins*, 519 U.S. 452, 462 (1997)); *Amoco*, 410 F.3d at 732 (noting "Dear Operator" letter not binding on agency because not authored by official with authority to announce binding rules). The guidance documents at issue here do not satisfy this standard.

Fourth, resting on its "reliance" theory, Levon suggests that the agency is bound by the guidance documents because, for a number of years, regulated parties followed the advice contained in the documents. This argument fails. In *Center for Auto Safety*, 452 F.3d 798, a case very much on point, the court held that policy guidelines issued by the Associate Administrator of the National Highway Traffic Safety Administration did not amount to a binding rule. The contested guidelines, which

related to automakers' voluntary regional recalls, were found not binding because the Associate Administrator had no authority to issue binding regulations or make a final determination on the issue. Importantly, the court also rejected the petitioner's argument that, merely because the agency and automakers had followed the guidelines for seven years, the guidelines had binding "legal consequences." In addressing this point, the court said:

> The flaw in appellants' argument is that the "consequences" to which they allude are practical, not legal. It may be that, to the extent that they actually prescribe anything, the agency's guidelines have been voluntarily followed by automakers and have become a de facto industry standard for how to conduct regional recalls. But this does not demonstrate that the guidelines have had *legal consequences.* The Supreme Court's decision in *Bennett* makes it quite clear that agency action is only final if it determines "rights or obligations" or occasions "*legal* consequences." 520 U.S. at 178. (citation and internal quotation marks omitted). Circuit case law cannot obviate the holding of *Bennett.*

Ctr. for Auto Safety, 452 F.3d at 811. *See also Nat'l Ass'n of Home Builders v. Norton*, 415 F.3d 8, 15 (D.C. Cir. 2005) ("[I]f the practical effect of the agency action is not a certain change in the legal obligations of a party, the action is non-final for the purpose of judicial review.").

Devon argues that our decisions in *Alaska Professional Hunters Ass'n v. FAA*, 177 F.3d 1030 (D.C. Cir. 1999), and *Paralyzed Veterans of America*,

117 F.3d 579, should control the disposition of this case. We disagree. In *Alaska Professional*, the court found that thirty years of uniform advice by the Alaskan regional office of the FAA "became an authoritative departmental interpretation" binding on the agency. The case is plainly distinguishable, however, because the disputed agency advice in that case had been upheld in a formal adjudication by the Civil Aeronautics Board, FAA's predecessor agency. *See Alaska Prof'l*, 177 F.3d at 1034 (discussing *Administrator v. Marshall*, 39 C.A.B. 948 (1963)). Indeed, the decision in *Alaska Professional* acknowledges that an interpretation or advice by an official without authority to bind the agency alone would not amount to an authoritative interpretation. *Alaska Prof'l*, 177 F.3d at 1035; *see also Hudson v. FAA*, 192 F.3d 1030, 1036 (D.C. Cir. 1999) (distinguishing *Alaska Professional* as concerning a binding interpretation on the basis of the formal adjudication upon which the longstanding practice was based); *Ass'n of Am. R.Rs.*, 198 F.3d at 949 (same). In this case, by contrast, the guidance documents have never been upheld in an agency adjudication, nor have they ever been endorsed in any other agency action having the force of law.

Paralyzed Veterans also lends no support to Devon's position. In that case, we held that Advisory Board guidelines that were not clearly adopted by the Department of Justice and a speech by a mid-level official did not amount to a binding interpretation of its regulation implementing the Americans with Disabilities Act. 117 F.3d at 588. The court noted that if the Department itself had adopted the Board's interpretation of the regulation

the outcome might have been different. *Id.* The case surely does not stand for the proposition that guidance documents written by persons without authority to bind an agency and released with no indication that the documents purported to have the force of law may be taken as binding interpretations of an agency regulation.

In sum, we find no merit in Devon's claim that it acted in reliance on the 1995 and 1996 guidance documents and that this "reliance interest is protected by the APA." As noted above, the guidance documents were far from conclusive in what they said. 20 In any event, on the record here, it is plain that the contested guidance documents did not come from sources who had the authority to bind the agency. Therefore, it does not matter whether the appellant, or others, followed the advice that was offered in these documents. These documents did not amount to a binding interpretation of the marketable condition rule, so the Agency was free to adopt the interpretation at issue in this case without providing an opportunity for notice and comment.

III. CONCLUSION

For the reasons indicated above, we deny Devon's challenge to DOI's Final Order and affirm the District Court's judgment in favor of the agency.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

DEVON ENERGY CORPORATION,	)	
	)	
Plaintiff,	)	
	)	
v.	)	
	)	Civil Action No.
GALE A. NORTON,	)	04-CV-0821 (GK)
Secretary of the Interior,	)	
	)	
Defendant.	)	
	)	

ORDER

For the reasons stated in an accompanying memorandum opinion, it is this 23rd day of August, 2007 hereby:

ORDERED: that plaintiff's motion for summary judgment [dkt #24] is DENIED; and it is further

ORDERED: that defendant's cross-motion for summary judgment [dkts #28 & #29] is GRANTED; and it is further

ORDERED: that this matter is DISMISSED WITH PREJUDICE.

/s/

Louis F. Oberdorfer
UNITED STATES
DISTRICT JUDGE

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

DEVON ENERGY CORPORATION,	)	
	)	
Plaintiff,	)	
v.	)	Civil Action No.
	)	04-CV-0821 (GK)
GALE A. NORTON,	)	
Secretary of the Interior,	)	
	)	
Defendant.	)	
	)	

MEMORANDUM OPINION

Plaintiff Devon Energy Corporation ("Devon"), a natural gas producer, seeks review of a decision by the Department of the Interior ("Interior").[1] Interior held that Devon could not deduct certain costs when it calculated the royalties owed to the government pursuant to its lease to extract natural gas from federally-owned land. Devon principally argues that Interior's decision violates the notice and comment provisions of the Administrative Procedure Act ("APA"), 5 U.S.C. § 553, because it reinterprets Interior regulations in a manner fundamentally different from the agency's prior interpretation of the same regulations. The following analysis establishes that Interior did not reinterpret a prior authoritative interpretation of its regulations in violation of the APA, and hence was not required to conform to the APA's notice and comment provisions.

---

[1] Judge Gladys Kessler referred the pending motions for summary judgment to this judge on December 22, 2006.

BACKGROUND

A. Statutory and Regulatory Background[2]

Beginning in the 1980s, technological innovations made possible the large-scale extraction of a natural gas variety known as "coalbed methane." Coalbed methane is gas that is trapped in underground coal seams and held in place by hydraulic pressure. To extract the gas, a producer like Devon lifts the pressure on the coalbed, causing the coalbed methane to escape. The gas is then captured and gathered to a central delivery point ("CDP"); removed of any excess carbon dioxide; and dehydrated and pressurized to render it suitable for transport. Only by completing this process does coalbed methane become marketable for use.

The federal government owns land in the Powder River Basin of Wyoming, which is rich in natural gas. It leases rights to extract the gas in exchange for a statutorily fixed percentage of the proceeds.[3] Interior, through its subagency the Minerals Management Service (MMS), promulgates rules for

---

[2] Much of the following statutory and regulatory background has been taken, without attribution for ease of readability, from then-Judge Roberts' opinion in *Amoco Production Co. v. Watson*, 410 F.3d 722 (D.C. Cir. 2005), and the Supreme Court's opinion in *Amoco Production Co. v. Southern Ute Indian Tribe*, 526 U.S. 865 (1999).

[3] The Mineral Leasing Act requires producer-lessees to pay the government-lessor "a royalty at a rate of not less than 12.5 percent in amount or value of the production removed or sold from the lease." 30 U.S.C. § 226(b)(1)(a).

the regulation of the relationship between the government and its natural gas lessees, and issues and administers the leases in accordance with those rules.

In 1988 MMS "amended and clarified" the rules "governing valuation of gas for royalty computation purposes." Revision of Gas Royalty Valuation Regulations and Related Topics, 53 Fed. Reg. 1230 (Jan. 15, 1988). These new rules specified that the "value of production" referred to in 30 U.S.C. § 226(b)(1)(A) must be no less than "the gross proceeds accruing to the lessee for lease production," minus certain allowable deductions. 30 C.F.R. § 206.152(h) (1988). A longstanding interpretation of the Mineral Leasing Act (MLA) obligates lessees to put the gas they extract in "marketable condition at no cost to" the federal lessor, thereby precluding deduction of such costs. *Id.* § 206.152(i); *see California Co. v. Udall*, 296 F.2d 384, 387-88 (D.C. Cir. 1961) (upholding marketable condition requirement).

Lease products are considered in marketable condition if they "are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area." 30 C.F.R. § 206.151. If a lessee sells "unmarketable" gas at a lower cost, the gross proceeds for purposes of royalty calculation must be "increased to the extent that the gross proceeds have been reduced because the purchaser, or any other person, is providing certain services" to place the gas in marketable condition. *Id.* § 206.152(i). To take a simple example, if it costs a producer $20 to put gas in marketable condition by dehydrating and compressing it, and the producer

sells the dehydrated and pressurized gas for $100, "gross proceeds" for purposes of royalty calculations is $100, regardless of whether the producer dehydrates and pressurizes and then sells the gas for $100, or instead sells the gas for $80 to a purchaser who dehydrates and pressurizes it.

Importantly, the regulations allow lessees to deduct from gross proceeds costs directly related to transporting the gas from the wellhead for sale at markets remote from the leasehold.

See id. § 206.157(a)-(b).

B. Factual Background

The facts of this case are undisputed.

Devon is a producer of coalbed methane and a lessee of the federal government in Wyoming's Powder River Basin. Devon gathers the gas from various wells in the Basin to CDPs, where the gas is measured to calculate the amount of royalty owed to the federal lessor. Pl.'s Stmt of Material Facts as to Which There Is No Genuine Issue ("Pl.'s Stmt") ¶¶ 2-4 (May 4, 2005) [dkt #24].

After being gathered to the CDP, the coalbed methane leaves the CDP through a pipeline to one of Devon's chemical plants, some 126 miles away. There Devon removes the excess carbon dioxide thereby rendering the gas into marketable condition for sale to third parties. To travel the pipeline, however, the gas also must be compressed and dehydrated. As noted above, Interior regulations permit Devon to deduct from their gross proceeds the costs relating to the transport of the gas to the chemical plant. However, the marketable condition

rule prohibits deductions of costs necessary to render the gas saleable "under a sales contract typical for the field or area," 30 C.F.R. § 206.151. The regulations do not expressly state whether the costs of dehydrating and compressing coalbed methane are (a) deductible transportation costs or (b) nondeductible costs for rendering the gas into marketable condition. *See* Pl.'s Stmt ¶¶ 5-10.

In November 1995 Interior convened the Royalty Policy Board to consider how the marketable condition rule should be interpreted with regard to these compression and dehydration costs. In 1995-96, the guidance generated from this meeting was distributed by way of two valuation and reporting Guidelines (the "Guidelines") published on Interior's website, as well as a Dear Operator Letter (the "Letter") sent to interested parties. *See id.* ¶¶ 12-21.

The parties dispute the meaning of the Board's specific guidance in the Guidelines and Letter. According to Devon, the Board allowed the producer to deduct the costs of dehydration and compression, provided they were incurred after the gas reached the CDP and were necessary for transportation. *See* Pl.'s Stmt of Points and Authorities in Support of Pl.'s Mot. for Summ. J. ("Pl.'s Mem.), at 9-10 (May 4, 2005) [dkt # 24]; Def.'s Mem. in Opp. to Pl.'s Mot. for Summ. J. ("Def.'s Mem."), at 9-10 (Jun. 17, 2005) [dkt #28]. According to Interior, the Board's conclusions were ambiguous and, if interpreted as Devon viewed them, erroneous. *See id.*; Def.'s Rep. to Pl.'s Opp. to Def.'s Cross-Mot. for Summ. J. ("Def.'s Rep."), at 7-10 (Aug. 17, 2005) [dkt #33]. Moreover, declares Interior, the Board was without authority to issue a binding, authoritative interpretation of the

marketable condition rule on behalf of the agency. *See id.* at 16.

In 2002, Devon requested that MMS confirm that deducting the post-CDP dehydration and compression costs from the royalty calculation, as set forth in the Guidelines and Letter, complied with Interior's marketable condition regulation. Pl.'s Stmt ¶ 26. In 2003, an Acting Assistant Secretary of the Interior ruled in a final agency decision that the Royalty Policy Board's interpretation of the regulations was either ambiguous or in error, and that Devon could not deduct the post-CDP dehydration and compression costs as transportation costs. *Id.* ¶ 27; Compl., Ex. B, at 25 (Agency Decision of Oct. 9, 2003) [dkt #1]. This litigation followed.

DISCUSSION

I. The Legal Standard

Summary judgment is granted if there is no genuine issue as to any material fact and if the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The standard of judicial review of Interior's interpretation of its own regulations implementing the MLA, the case here, is well known:

> Although [the courts] will not allow an agency to rewrite regulations under the guise of interpreting them, [they] nevertheless owe substantial deference to an agency's interpretation of its own regulations, giving that interpretation controlling weight unless it is plainly erroneous or inconsistent with the regulation. Such deference is particularly appropriate in the context of a complex and

> highly technical regulatory program [such as the MLA], in which the identification and classification of relevant criteria necessarily require significant expertise and entail the exercise of judgment grounded in policy concerns.

Amoco Production Co. v. Watson, 410 F.3d 722, 728-29 (D.C. Cir. 2005) (original alterations, quotation marks, and citations omitted).

II. APA § 553 Claim

Section 553 of the APA requires that a formal administrative rule be implemented through notice and comment procedures. *See Independent Petroleum Assoc. of America v. Babbitt*, 92 F.3d 1248, 1256 (D.C. Cir. 1996). The D.C. Circuit has also ruled, however, that "[o]nce an agency gives its regulation an interpretation, it can only change that interpretation as it would formally modify the regulation itself: through the process of notice and comment rulemaking." *Paralyzed Veterans of America v. D.C. Arena*, 117 F.3d 579, 586 (D.C. Cir. 1997). The question here is whether the Guidelines and Letter constitute an "authoritative interpretation," *id.*, of the marketable condition rule, such that Interior's repudiation in the decision presently under review must undergo notice and comment procedures. All parties agree that the Guidelines and Letter, standing alone, do not constitute an authoritative interpretation of a rule sufficient to bind the agency. *See Independent Petroleum*, 92 F.3d at 1256-57; Pl.'s Rep. in Supp. of Its Mot. for Summ. J. & Its Opp. to Def.'s Cross-Mot. ("Pl.'s Rep."), at 6 & n.4 (Jul. 13, 2005) [dkt #30]. Rather, Devon argues that these guidances plus subsequent actions by Interior comporting with their

interpretation is sufficient to bind the agency as an authoritative interpretation. *Id.*

The parties present two diverging paradigms for understanding the nature of Interior's actions. From Devon's perspective, the 1995-96 Guidelines and Letter uttered by the Royalty Policy Board constitute a new and not unreasonable interpretation of the marketable condition rule that has been in effect for over 60 years. The new interpretation of the rule was necessary to address the technological innovations in the 1980s making profitable the collection of coalbed methane. Thus, the Board was called upon to decide how the marketable condition rule would apply to this relatively recent practice of collecting and refining coalbed methane. In other words, Devon argues, the Guidelines and Letter are a new *application* of the marketable condition rule, which are binding on Interior.

Even if Devon's paradigm were correct, that does not mean it wins. As Devon acknowledges, the policy statements or informal interpretations in the Guidelines and Letter are not binding on Interior, *unless Interior affirmatively adopted them*, by way of complying with them in a longstanding practice. *See Alaska Professional Hunters Ass'n v. FAA*, 177 F.3d 1030, 1035 (D.C. Cir. 1999).

Interior's paradigm is quite different. Interior views the 1995-96 Guidelines and Letter as an anomaly or error in a long line of Interior policy statements and interpretations that have consistently interpreted, for decades, the marketable condition rule in accordance the view taken by the 2003 decision rejecting Devon's interpretation. Interior de-emphasizes the significance of the

newness of coalbed methane collection, noting instead that the original marketable condition rule applies to *all* natural gas. It cites a long line of adjudications and federal court decisions applying the marketable condition rule consistently with the 2003 decision, regardless of whether the costs of bringing the gas to a marketable condition were incurred before the gas reaches the CDP, at the CDP, or after it has passed through the CDP. According to Interior, the Guidelines and Letter (or Devon's interpretation of them) are an anomaly that sticks out like a sore thumb.

Moreover, Interior disputes that it ever authoritatively adopted the interpretation stated in the Guidelines and Letter. Although it acknowledges that since 1995-96 its employees may have approved deductions for coalbed methane like the ones Devon wishes to make, it also notes at least one instance since that time when it did not allow such a deduction. Moreover, Interior cites numerous decisions where, with respect to natural gas, it uniformly denied a transportation deduction based upon the geographic location (*i.e.*, downstream of the CDP) of the natural gas.

Interior has the better of the argument.

In favor of its paradigm, Devon relies principally on two cases, neither of which is controlling here. The first is *Shell Offshore Inc. v. Babbitt*, 238 F.3d 622 (5th Cir. 2001), in which the Fifth Circuit, purportedly relying on the D.C. Circuit's holding in *Alaska Professional*, held that Interior could not require an additional certification from FERC as a prerequisite to receiving a particular transportation deduction. The Fifth Circuit held that Interior's

"undeniably . . . long established and consistently followed practice" of not requiring an additional certification could not be altered without notice and comment. *Id.* at 630. Next Devon relies upon a district court case, *Torch Operating Co. v. Babbitt*, 172 F. Supp. 2d 113 (D.D.C. 2001), holding, on virtually the same facts as *Shell Offshore*, that Interior had failed to comply with APA notice and comment procedures before requiring the certification overlay for the approval of transportation deductions. *Id.* at 128.

These two cases facially appear to have analogous facts to the decision now under review. However, in both *Shell Offshore* and *Torch* there was no question that Interior had made a change in policy and departed significantly from a consistent, prior practice of not requiring the certification. *See Shell Offshore*, 238 F.3d at 630 (prior interpretation was "undeniably" a long established and consistently followed practice); *Torch*, 172 F. Supp. 2d at 125-26 (same). By contrast, in the case *sub judice*, there is considerable doubt whether Devon's preferred interpretation of the marketable condition rule is consistent with Interior's longstanding position that the rule does not permit deduction of costs based upon the geographic location of where the costs were incurred (here, upon leaving the CDP). *See Amoco*, 410 F.3d at 729 (upholding Interior's position in this regard). That is to say, it is not all clear that the 2003 decision is a departure from a longstanding practice of Interior. This alone suffices to distinguish the situation here from the cases relied upon by Devon, neither of which is controlling here.

Two cases that are controlling, on the other hand, address precisely the prerequisites necessary for guidances such as the Guidelines and Letter to become a definitive interpretation, binding on the agency and alterable only by way of notice and comment. In both cases, the D.C. Circuit held that where the agency's prior interpretation of a regulation—alleged to be invulnerable to change absent notice and comment—is either ambiguous (that is, not clearly a departure from the subsequent, definitive interpretation) or a mere policy statement, it is not binding on the agency, and the agency may render later decisions arguably inconsistent with the policy statement or ambiguous interpretation. Here, the Guidelines and Letter constitute a policy statement of enforcement, not an interpretation of the marketable condition rule; and even if considered such an interpretation, the interpretation is ambiguous, and hence Interior's 2003 decision rejecting Devon's deductions is not inconsistent with the marketable condition rule.

In the first case, *Hudson v. FAA*, 192 F.3d 1031 (D.C. Cir. 1999), the D.C. Circuit held that a 1989 advisory circular issued by the FAA was a policy statement rather than an interpretation of an FAA regulation and therefore not subject to the administrative law principle that a prior authoritative interpretation of a regulation can only be changed by notice and comment rulemaking. *Id.* at 1036 (*Alaska Professional*, 177 F.3d at 1035, and *Paralyzed Veterans*, 117 F.3d at 586, distinguished). The FAA's 1989 advisory circular called for actual demonstrations of an aircraft's safety but warned that these were "not the only means[] of compliance"

with FAA's regulatory requirements. *Id.* at 1033 (quoting the circular). The court held that abandoning the demonstration requirement did not require notice and comment.

Likewise, the Guidelines and Letter (allegedly) allow for the deductions Devon seeks from its royalty payments, but they also make clear that dehydration and compression costs that serve both transportation and marketable condition costs "should be referred to [MMS] to determine the appropriate allocation." Compl., Ex. G, Guidelines Memorandum, at 2 (Dec. 8, 1995); *id.*, Ex. H, Dear Operator Letter, at 3 (Apr. 22, 1996) (same); *see also id.*, Ex. F, Guidelines Memorandum, at 2 (Dec. 7, 1995) (confirming that lessee has burden of proving that dehydration and compression costs were related to transportation). Nothing in the Guidelines or Letter purports to reinterpret definitively the marketable condition rule with respect to coalbed methane. Rather, the guidance was issued at the request of several coalbed methane producers in San Juan, Arizona, because of confusion over their allowable costs. At that time, perhaps, MMS had a policy of allowing dehydration and compression costs that occurred post-CDP; but that does not mean Interior's decision to disallow the costs now is invalid: That decision "is not a different interpretation of the regulation, just an application of the regulation to a changed situation which calls for a different policy." *Hudson*, 192 F.3d at 1036.

Second, in *Darrell Andrews Trucking v. FMCSA*, 296 F.3d 1120 (D.C. Cir. 2002), the court of appeals held that a plaintiff making Devon's claim "must show that the 'agency has given its regulation a definitive interpretation, and later significantly

revise[d] that interpretation.'" *Id.* at 1125 (quoting *Alaska Professional*, 177 F.3d at 1034). The court held that where the agency has issued ambiguous guidances concerning its position on a regulation, as well as a clear decision that adhered to the agency's most recent understanding of the regulation, the ambiguous guidances did not constitute a binding "definitive interpretation." *See id.* at 1127-28. Likewise, here the Guidelines and Letter are arguably ambiguous (though Devon contends they are not). But even if the guidances are construed in favor of Devon's interpretation, a formal adjudication by Interior repudiates that view, *see J-W Operating Co.*, 159 IBLA 1, 12 (2003) (noting that "it has been held repeatedly that the [the costs for] dehydration of gas to meet market specifications for water content and the compression of gas to the pressure required for entry into the buyer's pipeline are not deductible"), and Interior cites at least one instance where Devon's position on calculating coalbed methane royalties was rejected by the agency, *see* Def.'s Rep., Ex. A. In light of this clear conflict, the balancing of which favors Interior's interpretation of the regulation, to paraphrase the D.C. Circuit in *Darrell Andrews*, "in the midst of the period in which [Interior] issued the ambiguous [Guidelines and Letter] relied upon by [Devon], it issued a clear decision that confirms the interpretation applied by the agency in this case. [Devon] is therefore unable to show that the decision below represents a substantial change in the agency's construction of" the marketable condition rule and cannot sustain a challenge under *Alaska Professional*. *Darrell Andrews*, 296 F.3d at 1128.

Finally, a word on *Alaska Professional*, upon which Devon relies heavily. In that case, the D.C. Circuit ruled that an agency violates § 553 when it affirmatively adopts an interpretation, by way of complying with that interpretation through longstanding practice, and then repudiates that interpretation without notice and comment. 177 F.3d at 1033-34 (relying on *Paralyzed Veterans*, 117 F.3d at 586). However, the court was careful to note that "when [an unauthoritative body] gives an interpretation of a regulation or provides advice to a regulated party, this will not necessarily constitute an authoritative administrative position, particularly if the interpretation or advice contradicts the view of the agency as a whole," and hence a subsequent rejection by the agency of that position will not violate § 553. *Id.* at 1035. Here, the views of the Royalty Policy Board are not authoritative on behalf of Interior. Devon concedes as much by acknowledging that absent some sort of longstanding, consistent adherence to the Guidelines and Letter, it cannot sustain its cause based on the Board's guidances. *See* Pl.'s Rep., at 5-6 & n.4; *Amoco*, 410 F.3d at 732 (holding that MMS guidance letters are not binding on the agency, and citing *Independent Petroleum*, 92 F.3d at 1257). Also, as the *Hudson* case made clear, *Alaska Professional* was a unique situation where the agency had adhered to a particular interpretation of the regulation for some thirty years, issuing formal adjudications that were consistent with and adopted that interpretation, before repudiating it. *See Hudson*, 192 F.3d at 1036; *Ass'n of American Railroads v. DOT*, 198 F.3d 944, 950 (D.C. Cir. 1999) (noting *Alaska Professional* relied on "administrative common law" to

substantiate the original interpretation). Finally, *Alaska Professional*'s holding has been further narrowed on the ground that it applies only where a turnabout in interpretation upsets substantial financial expectations based upon the original interpretation. *Id.*

III. APA § 706 Claim

Devon also claims that disallowing the post-CDP deductions for dehydration and compression costs is an unreasonable reading of the marketable condition regulation, and hence "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," 5 U.S.C. § 706. However, the judicial standard of reviewing with deference an agency's interpretation of its own regulations prevents overturning it pursuant to APA § 706. *See Auer v. Robbins*, 519 U.S. 452, 461-463 (1997); *Amoco*, 410 F.3d at 728-29; *see also Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-845 (1984).

Devon argues that Interior's interpretation of "marketable condition," that is, gas conditioned for the specific market into which it is actually sold, is contrary to the plain language of the regulation which defines marketable condition as gas conditioned to such an extent that it "will be accepted by a purchaser under a sales contract typical for the field or area," 30 C.F.R. § 206.151. However, this argument is foreclosed by *Amoco*, which held, in rejecting a substantially similar argument, that the regulation "does not contain a geographic limit." *Amoco*, 410 F.3d at 729. Devon also argues, much like the plaintiff in *Amoco*, that Interior departed from agency precedent and original

intent in issuing the 2003 decision prohibiting deduction of costs that were incurred past the geographical boundary of an off-lease central accumulation point. That argument also is foreclosed by the *Amoco* decision. *Id.* at 730. Finally, Devon argues, halfheartedly, that it alone is subject to the (allegedly) grievous 2003 Interior decision, and hence is being treated unfairly in comparison with other similarly situated gas producers. The argument is without merit, and Devon acknowledges that Interior has already begun to apply the 2003 decision to other gas producers. *See* Pl.'s Praecipe (Oct. 7, 2005) [dkt #40].

CONCLUSION

For the foregoing reasons, an accompanying order will deny plaintiff's motion for summary judgment and grant Interior's cross-motion for summary judgment.

/s/

Louis F. Oberdorfer
UNITED STATES
DISTRICT JUDGE

Dated: August 23, 2007

APPENDIX C

United States Department of the Interior
OFFICE OF THE SECRETARY
Washington, DC 20240

MAR 19, 2004

CERTIFIED MAIL –
RETURN RECEIPT REQUESTED

Mr. Gregg Henson
Assistant Controller
Devon Energy Corp.
20 North Broadway, Suite 1500
Oklahoma City, Oklahoma 73102-8260

Ms. Deborah Bahn Haglund
Haglund Law Firm
102 So. Broad St., Suite C
Cedar Hill, Texas 75104

Re: Request for Reconsideration or Clarification of Valuation Determination for Coalbed Methane Production from the Kitty, Spotted Horse, and Rough Draw Fields, Powder River Basin, Wyoming, dated October 9, 2003

Final Order to Perform Restructured Accounting and Pay Additional Royalties

Dear Mr. Henson and Ms. Haglund:

By letter from Ms. Haglund as counsel for Devon Energy Corp. (Devon) dated December 8, 2003, Devon requested "reconsideration and/or clarification" of the "Valuation Determination for Coalbed Methane Production from the Kitty, Spotted Horse, and Rough Draw Fields, Powder River Basin, Wyoming," dated October 9, 2003, (the "October 9

Determination"). This letter responds to that request ("the December 8 Request"), and also includes a final order to Devon to perform a restructured accounting and pay additional royalties due, as set forth more fully below. We will address these different components of the December 8 Request in the same order as they are raised. The October 9 Determination is incorporated herein by reference for all purposes.

RESPONSE TO REQUEST FOR RECONSIDERATION OR CLARIFICATION

I. Specific Ordering Language

The December 8 Request first observes that the October 9 Determination did not contain express mandatory or ordering language. We acknowledge that such language was not included in the October 9 Determination. Specific ordering language is included in this response below.

II. "Bundled Volumetric Fuel Deductions" and "Bundled Arm's-Length Transportation Rate"

Second, the December 8 Request (at p. 2) states that Devon "historically has not paid royalty on the bundled volumetric fuel deductions made by Bitter Creek and Thunder Creek, since it considers the entirety of this fuel to be part of its transportation cost." The original letter requesting the valuation determination, dated January 11, 2002, described the arrangements with Thunder Creek and Bitter Creek as follows:

> Devon has separate low-pressure transportation agreements with its affiliate,

> Thunder Creek Gas Services, L.L.C., for the Kitty Field and Spotted Horse areas.
>
> Devon has a low-pressure transportation agreement with Bitter Creek Pipelines, L.L.C., for the Rough Draw Field.
>
> * * *
>
> Devon has a high-pressure transportation agreement with Thunder Creek Gas Services, L.L.C., to move gas from any point on its high-pressure line to the tailgate of the Buckshot Plant.

January 11, 2002 request letter, p. 3. Thunder Creek is an affiliate of which Devon owns 75 percent. The low-pressure Thunder Creek lines are the lines extending from each of the central delivery points (CDPs) through the respective reciprocating compressors/field boosters and their associated dehydrators in the Kitty and Spotted Horse Fields. The Thunder Creek high-pressure system begins after the reciprocating compressors/field boosters and their associated dehydrators and extends to the terminus of the Thunder Creek line at the Buckshot Plant near Glenrock, Wyoming. The Bitter Creek low-pressure line (operated by Williston Basin) extends from the CDPs through the reciprocating compressors and associated dehydrators in the Rough Draw Field.

The January 11, 2002 request letter then specifically states, with respect to the Thunder Creek low-pressure systems (at p. 4):

> Since Devon owns 75 percent of Thunder Creek, the deduction [for the costs of the low-

> pressure pipeline system that Devon took] is based on a cost-of-service calculation, including actual fuel, rather than on the basis of the contract prices. Since service is purchased from Thunder Creek on an MMBtu basis, there are no costs associated with transporting CO_2.
>
> Attachment B sets forth a summary of calculations of rates based on the actual costs associated with capital investment, operating, and maintenance costs, with capital and depreciation calculated in accordance with MMS guidelines. Supporting information is provided on Attachment B-1. (Emphasis added.)

With respect to the Thunder Creek high-pressure system, the January 11, 2002 request letter (at p. 4) similarly states:

> Since Devon owns 75 percent of Thunder Creek, the deduction is based on a cost-of-service calculation, including actual fuel used by the pipeline. Since the contract with Thunder Creek is on a MMBtu basis, there are no costs associated with transporting CO_2.
>
> Attachment B sets forth a summary of calculations of rates based on the actual costs associated with capital investment, operating, and maintenance costs, with capital and depreciation calculated in accordance with MMS guidelines. Supporting information is provided on Attachment B-1.

With respect to the Bitter Creek low-pressure system, the January 11, 2002 request letter states (at p. 4):

> The contract is on an MMBtu basis and there are no costs associated with transporting CO_2. Since Williston Basin Interstate operates this transportation system, this transaction is arm's length and the basis for the deduction is the contract-rate, including pipeline fuel usage and lost and unaccounted for volumes.

We understand from further discussions between Devon's counsel and counsel for MMS concerning the "bundled volumetric fuel deductions" that the information that Thunder Creek furnished to Devon showed that for each of the two Thunder Creek low-pressure systems (Kitty and Spotted Horse), Thunder Creek deducted one overall volume amount from the gas that went through the system for all fuel used to power that system's operations. That includes primarily the screw compressors, reciprocating compressors/field boosters, and the dehydrators associated with the reciprocating compressors. There was also a relatively small percentage of the fuel gas that was used to power heaters for small buildings in which meters were located and to power tank heaters. In the December 8 Request, Devon refers to this figure as a "bundled" deduction because the figure given by Thunder Creek was not further broken down — *i.e.*, it did not itemize the fuel deductions by each particular compressor or dehydrator that the deducted volume was used to power. Devon refers to it as a "volumetric" deduction because the fuel was taken

from the gas flowing through the system and was not a payment in cash.

We further understand that the same is true for the Thunder Creek high-pressure system. In other words, Thunder Creek's information to Devon showed one overall volume amount deducted from the gas that went through the high-pressure system to power that system. This fuel primarily served to power the MTG Booster and compression at the Buckshot plant.

Finally, we understand that Bitter Creek likewise deducted one stated volume amount from the gas that passed through the Bitter Creek low-pressure system in the Rough Draw Field to power that system. Devon also paid some cash amounts to Bitter Creek as part of the payment under the arm's-length agreement between them. As was the case for the Thunder Creek low-pressure systems in the Kitty and Spotted Horse Fields, the deducted fuel volumes powered primarily the screw compressors, the reciprocating compressors, and the associated dehydrators. Presumably, a small percentage of the deducted volumes powered building heaters and tank heaters.

For the reasons explained in the October 9 Determination, none of the compressor and dehydrator costs for the Thunder Creek and Bitter Creek low-pressure systems are deductible. This would include fuel costs, whether paid in cash or paid (as here) as an in-kind deduction from the gas

flowing through the system.[1] With respect to these low-pressure systems, Devon's request that the Department "clarify" the October 9 Determination to "expressly state that Devon may continue to treat the entirety of the bundled volumetric fuel deductions made by Bitter Creek and Thunder Creek as part of its allowable transportation cost" appears to be simply a request to reverse the holding and result of the October 9 Determination. Devon has not shown why the costs of the screw compressors and the reciprocating compressors are not part of the costs incurred to put production into marketable condition, and has offered nothing to refute the analysis of the October 9 Determination. Devon therefore must determine the value of the deducted fuel gas used for those purposes and pay royalty on that value.

To the extent that the fuel costs for meter building heaters and tank heaters are not part of the costs of compression and dehydration and are part of the costs of the transportation line, those costs are part of the actual cost of transportation, and Devon may continue to not pay royalty on that portion of the fuel gas used for those purposes. We recognize

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[1] The documents MMS has received from Devon and Thunder Creek show, and Devon acknowledges, that all of the screw compressors with which we are concerned here are located downstream of the BLM-approved central accumulation point or point of royalty measurement. Devon therefore correctly included all production, including that portion deducted as fuel, in the royalty-bearing production removed or sold from the lease. (*See* 43 C.F.R. § 3162.7-3.)

that the "bundled" fuel deduction reported by Thunder Creek and Bitter Creek does not separately identify the fuel volumes used for each of the compressors, dehydrators, tank heaters, etc. But for Thunder Creek, Devon has access to the information to calculate the costs of the building and tank heater functions separately from the screw compressors and the reciprocating compressors and the dehydrators on the low-pressure system, because Devon owns 75 percent of Thunder Creek and can require this information from Thunder Creek. If Bitter Creek is unwilling to voluntarily disclose separate cost information to Devon for the Bitter Creek low-pressure system in the Rough Draw Field, Devon should confer with MMS to agree on an acceptable allocation between deductible and non-deductible amounts.

For the high-pressure system, the fuel costs are principally for the MTG Booster and compression at the Buckshot plant. The October 9 Determination already concluded that under the particular circumstances of this case, the costs of the MTG Booster would be allowable as transportation costs. (The costs of any other functions (other than compression at the plant) on the high-pressure system that the fuel gas was used to power likewise are deductible.) However, the costs of the compression undertaken at the Buckshot plant are not deductible. Therefore, Devon must obtain from Thunder Creek a separate calculation of the volume of fuel used for compression at the plant, determine the value of that volume, and pay royalty on that value. For the Thunder Creek high-pressure system, Devon may continue to not pay royalty on that

portion of the volumetric fuel deduction allocable to the MTG Booster and other functions of the high-pressure system unrelated to compression at the plant, subject to the limitation described in the next paragraph.

Devon's description of the Thunder Creek high-pressure system in the January 11, 2002 request letter, as quoted above, stated that "the deduction is based on a cost-of-service calculation" and because the contracts were on an "MMBtu basis" that "there are no costs associated with transporting CO_2." But because the "bundled" deduction reported by Thunder Creek as fuel was a volume deduction, it is unclear from this description whether the volume Thunder Creek reported as deducted included all fuel- including the portion of the fuel allocable to moving the CO_2 portion of the gas stream — or was limited to the portion of the fuel allocable to moving the methane only. To the extent that the deduction included the portion of the fuel allocable to moving the CO_2, that portion is not deductible as a transportation cost. Devon therefore would have to calculate the value of that portion of the deduction and pay royalty on that value.[2]

The December 8 Request (at p. 2) also states that "Devon historically has deducted the entirety of the

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[2] It is not necessary to address this issue in the context of the Thunder Creek low-pressure systems and the Bitter Creek low-pressure system because none of the compression costs for those systems are deductible for the reasons explained above.

bundled arm's-length transportation rate it pays to Bitter Creek for transportation past the central delivery point in the Rough Draw Field." Devon asks that the Department "clarify" the October 9 Determination "to expressly state that Devon may continue to deduct the bundled arm's-length transportation rate it pays to Bitter Creek." We understand from subsequent discussions with Devon's counsel that Devon paid Bitter Creek some amounts in cash under its arm's-length agreement in addition to the deducted fuel volumes. (These cash amounts are what Devon refers to by the expression "bundled arm's-length transportation rate.") Devon's understanding is that part of the cash payment covers some costs of compression and dehydration, and some covers other functions. As explained above, Devon may not deduct the costs of the screw compressors and the reciprocating compressors and the dehydrators. To the extent the "bundled arm's-length transportation rate" includes costs allocable to the compressors and the dehydrators, Devon may not deduct that portion of the transportation rate. To the extent the amounts paid in cash are not for compression or dehydration, Devon may deduct those amounts as transportation costs, for the reasons explained in the October 9 Determination. Because it appears that the amounts paid in cash consist of both deductible and non-deductible elements, Devon should consult with MMS to determine an acceptable allocation if it is unable to obtain further information from Bitter Creek.

III. Reconsideration in View of Asserted "Facts"

Third, the December 8 Request asks that the Department "reexamine" the October 9 Determination in light of what your letter styles as factual arguments. Each will be addressed in turn. Devon first argues:

> You find that, to the extent that compression occurring prior to the [Buckshot] plant is duplicative of the compression performed at the plant, it is reasonable to conclude that the primary purpose of the upstream compression is to transport the gas to the plant.
>
> The same rationale applies to the screw compressors and reciprocating compressors that you have said are not deductible, and to the dehydration associated with that compression, which you have said is also not deductible. If the Buckshot Plant had been located in the field, with slight mechanical modifications, all of this compression and dehydration could have been done at the plant, only once.
>
> The screw compressors, reciprocating compressors, and associated dehydration in the field are needed only because the gas must be transported over a hundred miles to the plant, where the gas is then compressed and dehydrated again to meet pipeline specifications. Applying your own rationale, the screw compressors, the reciprocating compressors, and the associated dehydration in the field should all be deductible as part of the cost of transporting the gas from the central delivery point in the field to the plant.

December 8 Request, pp. 2-3 (emphasis in second paragraph added; emphasis in third paragraph in original).

This argument is inconsistent with Devon's prior description of the physical operation of the compressors. According to Devon's own description, as explained in the October 9 Determination, gas was recompressed at the Buckshot Plant from approximately 800 psi to 1100 psi —not from 2-10 psi (the inlet pressure at the screw compressors) to 1100 psi. The compression performed at the screw compressors and the reciprocating compressors was not "duplicative" of compression performed at the plant.[3]

Nor would relocating the plant to a point in or near the fields have resulted in the plant duplicating the compression performed at the screw compressors and the reciprocating compressors. Had the plant

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[3] Additionally, it is appropriate to reiterate that the October 9 Determination allows the entire cost of the MTG Booster because of the impracticality of attempting to allocate its cost between non-deductible compression that was not done again at the plant (*i.e.*, increasing pressure from approximately 550-600 psi, the exit pressure from the reciprocating compressors, to approximately 800 psi, the inlet pressure at the plant), and deductible compression that was either done again at the plant (increasing pressure from 800 to 1100 psi) or that may have exceeded the pipeline delivery pressure (1200 psi minus 1100 psi). Because of the impracticality of attempting to allocate the cost of the MTG Booster, Devon effectively has been allowed a somewhat greater allowance than what it actually is entitled to under the applicable rules if an exact allocation could be performed.

been located in the field, it may have been theoretically possible to redesign the plant to make it powerful enough to draw all the gas from very low initial pressures at all of the dozens of wells over various distances (ranging up to more than 20 miles from some of the wells) and perform all compression to 1100 psi at the plant. (This presumably would have required considerably more than "slight mechanical modifications' to the plant.) But even if that had been the case, it would not have made the compression costs deductible. The hypothesis that compression could have been done in some other way does not make the compression that in fact was done at the screw compressors and 'the reciprocating compressors unnecessary. Nor does it imply that such compression was not necessary to put the production into marketable condition.

Devon next argues:

> You [the Acting Assistant Secretary] acknowledge on page 17 of your decision that "marketable condition" means "lease products that are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area." 30 C.F.R. §206.151. With respect to gas produced from the Powder River Basin, Devon believes that its working interest partner, Redstone Resources, Inc., sells gas to unrelated third parties in the field at pressures less than 1200 psi under contracts typical for the field or area. Based on these facts, Devon respectfully requests that you reconsider your determination that the gas produced from the

> same fields or area and sold at the tailgate of the Buckshot plant is not in marketable condition until it is compressed to 1200 psi. "

December 8 Request, p. 3. First, this argument appears to mildly mischaracterize the October 9 Determination. The October 9 Determination did not say that gas sold at the tailgate of the Buckshot plant is not in marketable condition until it is compressed to 1200 psi. As explained in the valuation determination, the documents MMS received from Devon and Thunder Creek indicated that gas is compressed at the plant to a delivery pressure of 1100 psi, not 1200 psi. The October 9 Determination holds that the gas delivered at the tailgate of the plant must be at the pressure required to enter the receiving pipeline that takes the gas to its market. In the case of that gas, that happens to be 1100 psi.

Second, Devon has done nothing more than assert that it "believes" that Redstone Resources sells other gas at pressures less than 1200 psi. Devon has put nothing into the record to show at what pressures and into what markets Redstone actually sells its gas.

Third, in any event, whether Redstone sells some gas at lower pressures ultimately is irrelevant. (Indeed, we may assume, *arguendo*, that it does so; Devon itself sells some gas at the Landeck Header at approximately 550 psi.) As explained in the October 9 Determination, whether particular gas is in marketable condition is not a function of the lowest pressure at which <u>any</u> of the gas is in marketable condition. As is the case here, gas produced from large fields may serve more than one

market. Particular gas must be in marketable condition for the market it serves, which requires that it be at the pressure necessary to enter the pipeline that takes the gas to that market. The fact that the gas sold at the Landeck Header was in marketable condition at 550 psi does not imply that all the gas is in marketable condition at that pressure.

Devon's implicit theory is analogous to the theory that the court rejected in *Amoco Production Co. v. Baca and Vastar Resources, Inc. v. Baca*, Civil Nos. 00-02933 and 00-1480 (D.D.C. Nov. 14, 2003), *appeal pending*, No. 04- _____ (D.C. Cir.). There, the lessees sold a small percentage of coalbed methane production into a small local market in the vicinity of the lease without first removing the CO_2. The lessees argued that all the gas was in marketable condition because some of it was sold without CO_2 removal. The fact that gas did not need to be conditioned to meet the requirements of the local purchaser did not imply that the rest of the gas was in marketable condition. The court held that the Secretary properly required the lessees to condition the rest of the gas to pipeline CO_2 content requirements to serve the more distant markets into which it was sold.

IV. "Prior Practice and Policy"

Finally, Devon argues that the October 9 Determination "ignore[s] the agency's prior practice and policy as reflected in the December 1995 Deputy Director's memoranda" and that notice-and-comment rulemaking is required to change the "practice." December 8 Request, p. 3. Devon relies on *Shell Offshore, Inc. V. Babbitt*, 238 F.3d 622 (5th Cir.

2001) and *Torch Operating Co. v. Babbitt*, 172 F. Supp. 2d 113 (D.D.C. 2001).

As explained in the October 9 Determination, certain specific aspects of the December 7, 1995, and December 8, 1995 internal memoranda from the then-Deputy Director of the MMS to two Associate Directors were (at least as subordinate MMS officials apparently had read them and applied them in practice) inconsistent with or misinterpreted the marketable condition rule itself. It is well established that a Federal agency is not bound by unauthorized acts of its employees. The issuance of internal memoranda between subordinate agency officials that in certain respects appear to misinterpret a rule that has been in existence for many years before those memoranda were even written does not require notice-and-comment rulemaking under the Administrative Procedure Act (APA), 5 U.S.C. § 553, to correct the subordinate officials' errors.

The situation in the instant case is not like the situation in either *Shell Offshore or Torch*. In those cases, the 1988 MMS crude oil valuation rules provided for an exception to the requirement that a lessee calculate actual transportation costs in non-arm's-length transportation situations. The exception was that a lessee could apply to use a "tariff for the transportation system approved by the Federal Energy Regulatory Commission (FERC)" in lieu of calculating actual costs. Former 30 C.F.R. § 206.105(b)(5) (1988-1999). After FERC held that it did not have jurisdiction over certain offshore pipelines, MMS, in the two cases cited, denied use of tariffs that the respective lessees had filed with

FERC unless the lessees could show that FERC did have jurisdiction to adjudicate a tariff for the pipeline. But since the promulgation of the rule in 1988, MMS had always allowed use of tariffs that merely had been filed with FERC and had never required lessees to affirmatively demonstrate FERC jurisdiction to adjudicate them. As a result, the courts in both *Shell Offshore and Torch* held that changing MMS' longstanding (and from the rule's inception, uniform) interpretation of the rule required APA notice-and-comment rulemaking.

In the instant case, the marketable condition rule pre-dated the internal MMS memoranda by at least 53 years for onshore leases and 41 years for offshore leases. The December 1995 memoranda did not reflect a longstanding and uniform agency interpretation of a regulation from the inception of the regulation. Neither *Shell Offshore nor Torch* implies that notice-and-comment rulemaking is necessary to correct any and all interpretive errors of a subordinate agency official. Devon's reliance on these cases under the current circumstances therefore is misplaced.

ORDER TO PERFORM RESTRUCTURED ACCOUNTING AND PAY ADDITIONAL ROYALTIES

Devon's deduction of the costs of the screw compressors, reciprocating compressors, dehydrators, and compression at the Buckshot plant constitutes a systemic error in Devon's royalty payments. For all of the reasons explained above and in the October 9 Determination, the Department of the Interior hereby orders Devon to perform a restructured accounting and pay additional royalties on the coalbed methane produced from the Federal leases in the Kitty, Spotted Horse, and Rough Draw Fields that are the subject of the October 9 Determination in accordance with the October 9 Determination, as clarified by the discussion above responding to Devon's December 8 Request. The restructured accounting must cover the period beginning when Devon began paying royalties to the Minerals Management Service on the coalbed methane produced from the Federal leases in each of the three fields to the present.

To comply with applicable regulations, Devon is ordered to perform the following steps within 60 days of receipt of this order.

- Restructure the accounting for the leases and wells for which Devon pays Federal royalties for coalbed methane sales from the Kitty, Spotted Horse, and Rough Draw Fields, Wyoming, starting with the sales months in which such payments were first made to the MMS and continuing to the present. The allowances must be restructured to reflect the valuation

determination dated October 9, 2003, as clarified by this letter and order.

- Report and pay any additional royalties shown to be due to, MMS based on the restructured accounting.

If Devon believes that 60 days, is not a sufficient time within which to perform the restructured accounting and report and pay, MMS may grant an extension of that time upon Devon's request and Devon's showing of what additional time is necessary and reasonable.

Hereafter, Devon must report and pay royalties under the regulations and guidelines discussed in this order. In the future, if Devon does not perform the required accounting or pay royalties in compliance with this order, we may treat the violations as willful. 30 C.F.R. Part 241, Subpart B (2003).

If Devon agrees with this order and voluntarily reports and pays to MMS, the modified Report of Sales and Royalty Remittance (Form MMS-2014) and payment must reach MMS within 60 days from the date Devon receives this order unless MMS grants an extension of that time. Devon must keep all documents supporting compliance with this order until MMS completes its follow-up compliance testing.

When reporting and paying, please:

- Use procedures outlined in 30 C.F.R. § 210.20 for electronic reporting of Form MM-2014. Chapter 9 of the Minerals

Revenue Reaorter Handbook-Oil, Gas, and Geothermal Resources (handbook) describes bow to report using electronic commerce.

- Use procedures outlined in 30 C.F.R. § 218.51(b) (2003) for electronic payments. Be sure to reference the Form MMS-2014 block 4 number in the electronic payment document.

- Use adjustment reason code 17 on Form MMS-2014. Place the number 72000100 in block 4.

- Call 800-525-0309 for assistance in reporting and payment.

After MMS receives payment, MMS will compute late-payment charges and bill Devon as required by 30 C.F.R. § 218.102 (2003).

If Devon does not comply with this order, we may assess civil penalties under section 109 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), 30 U.S.C. § 1719, and 30 C.F.R. Part 241, Subpart B (2003), for failure to comply with statute, regulation, order, or terms of the lease.

Because this order is issued by an Assistant Secretary of the Department of the Interior, it is not subject to appeal to the Interior Board of Land Appeals and is the final action of the Department. *See Blue Star, Inc.*, 41 IBLA 337 (1979); *Marathon Oil Co.*, 108 IBLA 177 (1989). Further, because this order is issued by an Assistant Secretary, the provisions of 30 U.S.C. § 1724(d)(4)(B)(ii)(V)

regarding administrative appeal of the order do not apply.

For answers to questions, please call Mary Williams, Manager, Federal Onshore Oil and Gas Compliance, MMS at (303) 231-3403.

/s/

Chad Calvert
Acting Assistant Secretary
for Land and Minerals
Management

Enclosure: Acting Assistant Secretary's Valuation Determination for Coalbed Methane Production from the Kitty, Spotted Horse, and Rough Draw Fields, Powder River Basin, Wyoming, dated October 9, 2003

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 07-5299 **September Term 2008**
04cv00821

Filed On: February 13, 2009

Devon Energy Corporation,
Appellant

v.

Kenneth Lee Salazar, Secretary of the Interior,
Appellee

BEFORE: Sentelle, Chief Judge, and Ginsburg,* Henderson, Rogers, Tatel, Garland, Brown, Griffith, and Kavanaugh, Circuit Judges, and Edwards and Silberman, Senior Circuit Judges

ORDER

Upon consideration of appellant's petition for rehearing en banc, and the absence of a request by any member of the court for a vote, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk

BY: /s/
Michael C. McGrail
Deputy Clerk

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* Circuit Judge Ginsburg did not participate in this matter.

APPENDIX E

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 25165
Denver, Colorado 80225-0165

Apr 22, 1996

Dear Operator/Payor:

The Minerals Management Service (MMS) has received many questions, primarily from producers in the vicinity of New Mexico's San Juan Basin, on how to report and pay royalties on coalbed methane. The following guidelines answer those questions.

These guidelines apply to coalbed methane produced from Federal and Indian leases. You must follow these guidelines to ensure proper payment of royalties and correct reporting of production. They apply specifically to circumstances where carbon dioxide (CO_2) is removed from produced coalbed methane and is vented without sale.

Valuing Production

Sales at the wellhead or CDP

If you sell your coalbed methane at the wellhead or a central delivery point (CDP) in the field or unit, you must value the coalbed methane as unprocessed gas under 30 CFR § 206.152 (1995).

For arm's-length sales, value for royalty purposes will be the gross proceeds you receive under your arm's-length contract. However, that value cannot be reduced, either directly or indirectly, for the costs

of placing coalbed methane in marketable condition. Placing production in marketable condition includes, but is not limited to, CO_2 removal (commonly called sweetening). Under 30 CFR § 206.152(i), if your sales price is reduced by fees for services to place production in marketable condition, either directly or indirectly, you must add that portion of the fees attributable to those services, including CO_2 removal, to your gross proceeds received from the sale of the coalbed methane to determine value for royalty purposes. If you pay a bundled fee for both CO_2 removal and transportation, we recognize that you may be unable to obtain the information necessary to segregate the CO_2-removal costs. If you are in this situation, contact the MMS' Valuation and Standards Division at 303-275-7240 for assistance in determining the portion of your service fees attributable to CO_2 removal.

For non-arm's-length sales, you must determine the value of the coalbed methane under the methods (benchmarks) described at 30 CFR § 206.152(c). Again, you cannot deduct costs of placing the coalbed methane in marketable condition. You must ensure that any value determined under the methods is not improperly adjusted for nonallowable costs.

For Indian leases, you must also meet the dual accounting and majority price requirement established by regulation and lease terms. However, for both Federal and Indian leases, under no circumstances can the value of the production for royalty purposes be less than the gross proceeds accruing to the lessee, less applicable allowances.

Sales at the CO_2-removal facility

If you sell your coalbed methane at the tailgate of a CO_2-removal or other treating facility, you must value it as unprocessed gas under 30 CFR § 206.152. For arm's-length sales, value will be your gross proceeds under the arm's-length contract. For non-arm's-length sales, you must determine the value of the coalbed methane under the benchmarks at 30 CFR § 206.152(c). You cannot deduct costs of removing the CO_2 or otherwise placing the coalbed methane in marketable condition. However, you can deduct costs of transportation as discussed below.

Determining Allowable Deductions From Value

Transportation allowances

You can take a transportation allowance for your reasonable, actual, and necessary costs of transporting the coalbed methane from the royalty measurement point (either the wellhead or the CDP) to the point of sale remote from the lease. You must use the regulation in 30 CFR § 206.156 and 206.157 (1995) and the instructions in Chapter 6 of the *Oil and Gas Payor Handbook, Volume III,* to calculate your transportation allowance.

In general, the regulations state that (1) you must allocate your transportation charges to all products produced and transported, and (2) you can only deduct the allocated costs from the value of products that are royalty bearing. For coalbed methane production, you can increase the transportation costs allocated to the methane component for the amount of CO_2 permitted in the main (inter- or intrastate) transmission line. For example, if your gas stream consists of 90 percent

methane and 10 percent CO_2 and the main transmission line allows 2 percent CO_2 in the makeup of its gas stream, you can include the costs of transporting the 2 percent CO_2 volume (or 92 percent of the total transportation cost) when calculating your allowance for methane.

You can include costs of dehydration occurring after metering at the royalty measurement point in your transportation allowance but you cannot deduct costs of dehydration occurring at the wellhead. You can include costs for compression occurring downstream of the royalty measurement point, to the extent the compression is necessary for transportation. This includes compression at the CDP and in the transportation system to the CO_2-removal facility. You cannot include those compression costs associated with production operations.

You must convert any payment for transportation that is made in-kind for dehydration and allowable compression to a dollar equivalent and include this amount in the transportation allowance deduction. You must allocate transportation costs for any allowable dehydration and compression (either in-value or in-kind) between the methane and CO_2 in the same manner as the in-value transportation cost.

You cannot include the costs of removing CO_2 as part of your transportation allowance. If you pay a bundled fee for both transportation and CO_2 removal and are unable to segregate the fee between these two services, the MMS' Valuation and Standards Division will help you determine the proper portion attributable to transportation.

Processing allowances

You cannot take a proceeding allowance for your costs of removing CO_2.

Other deductions

You cannot include any costs associated with moving the production from the wellhead to the CDP (gathering) when the Bureau of Land Management (BLM) has approved the CDP as the royalty measurement point.

You cannot include any costs associated with wellhead separation.

Reporting Production

For each lease or agreement producing coalbed methane, you must report the total volume of gas measured at the BLM-approved royalty measurement point on the Monthly Report of Operations (Form MMS-3160) as a Gas Transfer. Report the four-digit gas plant number and name of the plant receiving the largest volume of gas from the property (if gas is being transferred to more than one plant) in the Plant Number/Name field. If you are using additional plants for CO_2 removal,,,, identify the other plant(s) in the Comments section.

Report the Btu content of the gas, as determined at the royalty measurement point, on the API Gravity/Btu Content line. Report the percentage of CO_2 in the gas stream, as measured at the royalty measurement point, in the Comments section.

If you report gas as Used on or for Benefit of Lease, you must be consistent with the approvals of BLM. Do not include any gas used off-lease for

compression, dehydration, or CO_2 removal unless specifically approved by BLM.

Reporting Royalty

For each lease/revenue source combination, you must report the allocated share of the total volume of gas determined at the BLM-approved royalty measurement point in the Sales Quantity field on the Report of Sales and Royalty Remittance (Form MMS-2014). Report the gas as unprocessed gas (Product Code 04) using Transaction Code 01, Royalty Due. Report the Btu content of the gas, as determined at the royalty measurement point, in the Quality Measurement field.

Base the value reported in the Sales Value field on the criteria described in the Valuing Production section of this letter.

Report transportation allowances against Product Code 04 using Transaction Code 11.

If you have any questions about production or royalty reporting, contact the MMS Reports Branch at 800-525-0309 or 303-231-3288.

Sincerely,
/s/
Robert E. Brown

Acting Associate Director for Royalty Management